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NOTES AND MEMORANDA

THE POSSIBILITY OF CERTAIN GAINS FROM PROTECTIVE DUTIES

IN his recently published *Principles of Economics*,¹ Professor Taussig develops a quasi-hypothetical case (having, however, possible relevance to the conditions of the United States) in which he contends that the disadvantages of protection may, to some extent, be offset by an increased purchasing power over foreign, as distinguished from domestic, commodities. The first influence of even a purely revenue duty, and still more of a protective duty, being, as he points out, to lessen imports, the movement of specie will be into the country. Prices and incomes rise in the country, and fall in foreign countries. Exports are checked, imports stimulated. "If the commodities exported from a country are of a sort insistentlly demanded in foreign countries; and if, on the other hand, the commodities which it imports are not such as to be consumed more largely as their prices fall, — then the change (in money income and prices) may be considerable. Eventually equilibrium is re-established; exports diminish and imports increase until payments again balance. When this stage is finally reached, the country which imposed the duties will have higher incomes and higher prices. The higher incomes will be no benefit so far as domestic purchases go, since within the country prices have risen in the same proportion. But they will be of advantage in the purchase of things imported."

The result is, he thinks, that there will be a balance of gain and loss. The consumers lose as purchasers of the protected articles, but they gain as purchasers of things

¹ Book IV, chap. xxxvii, sec. 1.

that continue to be imported. It is true that of these some are subject to the protective duty; but the consumers gain if the price is not raised by the full extent of the duty, and, even if it is, there is "a full recompense" in the revenue received by the public treasury, and by the consumer being relieved (presumably) from other taxes. The consumers gain, also, on all non-dutiable foreign imports which still continue to come in.

This reasoning Professor Taussig proceeds to apply to the case of the United States, as to which he comes to the final conclusion that it is impossible to calculate "how far the gain from this source has served to offset the loss from the domestic commodities produced and sold at higher cost." "It is a gain," he rightly says, "little reckoned with in the popular controversy."

It may be added, that it is a gain — so far as the present writer is aware — not much reckoned with, even by economists, in the case of *protective* duties, tho a similar doctrine, as will afterwards be pointed out, was held by Mill to be applicable to duties that were imposed for revenue purposes and had no protective effect. The present writer ventures, with great diffidence, to submit, for reasons now about to be set forth, that as applied to high protective duties which are really effective the whole argument is unsound.

It is not clear, in the first place, how the inflow of specie mentioned in the text can result in a *permanent* rise of incomes and prices, except under conditions which would deprive the rise of real significance. It will, of course, cause a temporary rise, while the balance of imports and exports is being adjusted. After the so-called equilibrium has been reached, the advantage of the higher incomes "in the purchase of things imported" can only be realized at the expense of an increased outflow of specie which will tend to reduce prices and incomes in the protected country. If this increased outflow is precluded by the hypothetical conditions of international demand, then all that has happened is that there has been a redistribution of the enlarged income, by which the consumer gets the same (or, more

probably, a less) amount of domestic and foreign commodities as before, paying considerably more for the former, and somewhat less for the latter.¹ It is not evident in what his advantage consists. It is no benefit that foreign commodities are cheaper if he cannot purchase more of them than formerly except on the old terms.

The argument may, perhaps, be more readily understood if it is pointed out that the word "equilibrium" is ambiguous. It may mean either an equilibrium of quantities, or of rates. In the former case, a stationary condition of trade is implied; x imports would exchange for y exports, neither more nor less. In the latter case imports would exchange for exports *at the rate of* x imports for y exports, which might be satisfied by $2x$ for $2y$ or $3x$ for $3y$ and so on. The latter is the sense which, it would seem at first sight, was the one intended. It is against this view that the foregoing criticism is aimed. The contention is that the possibility of exchanging x imports for y exports depends on a certain distribution of specie, and that any attempt to increase the volume of the trade and the advantage in the same ratio would fail because it would disturb this distribution. A nation, for instance, which, under a system of free exchange, had an import of 1,000,000 tons and an export of the same amount, might after adopting a protective tariff get 800,000 tons of imports for 600,000 tons of exports. But it would not be possible for the trade to expand in this ratio so that 1,600,000 tons, say, were obtained for 1,200,000 or even the original 1,000,000 tons of imports for 750,000 tons of exports.

The foregoing arguments apply to all foreign commodities, taxed and untaxed. In regard to imported commodities subject to the protective duty, if the price has been raised to the full extent of the duty, the advantage vanishes altogether. The suggestion that the consumer gets a "full recompense" in the relief from other taxation overlooks

¹ "Considerably more," because the fund available for domestic purchases created by the inflow of specie is still further augmented by the savings in the reduced price of the foreign goods.

the fact that the duties are levied for purposes of protection, and would not have been imposed had a protective policy not been decided upon. The case of a purely revenue tax is, in this connection, unimportant.

If, on the other hand, the rise in price is not to the full extent of the duty, it is because equilibrium has been established at a point short of this result. The supposed advantage has not *pro tanto* been availed of. A further demand for imported articles, if the hypothetical conditions of reciprocal demand would permit of it, could only result in tending to raise their price to the full level of the duty, when the advantage of the higher incomes in the purchase of foreign commodities will be no greater than in the purchase of domestic.

So far the reasoning has proceeded strictly on the lines laid down by Professor Taussig. There is, however, another and simpler way of approaching the subject which has the advantage of disentangling the controversy from intricate questions as to flow of specie and rise of prices. That is, to regard all such matters as mere mechanism and to look only to the broad fact that foreign trade is in its essence a case of barter, the profits of which arise from the extra product created by international division of labor. Regarded in this light Professor Taussig's obvious meaning is that in the adjustment of the equilibrium the lion's share of the advantage derived from mutual trade will fall to the protected country; it will get a larger share in the extra product created by the international division of labor, its imports will be obtained with a smaller volume of exports, foreign and domestic prices being automatically adjusted at the equilibrium point so that this result is secured. Even, however, under a regime of free exchange the assumed conditions secure the lion's share of the extra product to the country having the least insistent demand for imports, and for whose exports there is the most urgent demand abroad. It does not, necessarily, or indeed probably, follow, that protection will increase this advantage. It may increase *the share* in the extra product falling to the protected country,

but it will certainly diminish *the total to be divided*. If, for example, the increased annual product derivable from international trade under conditions of free exchange were some 50,000 tons, say, of iron or steel, and under protection only 30,000, then if the protected country got $\frac{2}{3}$ ths of the amount in the former case, and $\frac{4}{5}$ ths in the latter, it would make a less gain by 6,000 tons, and the loss would be a continuing one as long as the conditions lasted.

Even if it secured the whole extra product, and not merely $\frac{4}{5}$ ths of it, the protected country would make no profit, and would only just avoid a positive loss. The more effective the protection, the less will be the extra product, and the smaller will be the possible gains to be made by an increased share of it. A real gain is in general only conceivable where the product suffers a comparatively trifling diminution, *i. e.*, the duties imposed do not protect, or protect only to a slight extent. They are then hardly distinguishable from revenue duties, and we come back substantially to the position taken up by Mill (*Principles*, Book V, chap. iv, § 6). Mill, it will be remembered, draws a sharp distinction in this respect between revenue and protective duties, holding that the former may give rise to a gain in the conditions of international exchange, which will not be the case if the duties are of a protective character. This view would seem to be substantially correct, tho somewhat too narrowly expressed. Duties only slightly protective, which resulted in but an insignificant diminution of the product, would give practically the same result as duties for revenue only. The same effect might also be produced even with a great diminution of the product if it were accompanied by a very large increase in the proportion in which it was shared (say in the example given above from $\frac{1}{3}$ th to $\frac{4}{5}$ ths), but this is not likely to occur, save in very exceptional circumstances; the proportion secured by the protected country being by hypothesis great, even in the absence of protection.

Put in a nutshell, the point is that to speak of "offsetting" the losses of protection by "the gain" in the terms of international exchange implies a confusion between two

entirely different things (1) a loss in total amount or volume of produce, (2) a gain in the ratio in which that amount is divided. You cannot set off, *e. g.*, a gain of " $\frac{1}{5}$ th" against a loss of "4 tons" until you have reduced the terms to a common denominator by answering the question " $\frac{1}{5}$ th of what"? The answer is, in the case of international trade, $\frac{1}{5}$ th of the total product or, more precisely, of the extra product resulting from the international division of labor. If the total is *constant* or nearly constant (which is the case of a revenue duty or of a duty but slightly protective), the $\frac{1}{5}$ th is a real gain. If the total *diminishes greatly* (the case of high protection when really effective), the nominal gain of $\frac{1}{5}$ th is in reality a loss. Two-fifths of ten oranges is four oranges, three-fifths of five oranges is three oranges; a nominal gain of one-fifth, a real loss of one orange.

The application of the foregoing reasoning to the case of the United States is obvious. If the principal condition under which protective duties can favorably influence the terms of international exchange is that they should be very moderate in amount, there would appear to be no possibility of any gain having resulted to the States from this source — provided of course that the protection has been effective. If for any reason it failed to protect, other considerations would arise.

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WAGES AND ABILITY

THE subject of wages and ability has been a fertile one for speculation since the economists of the marginal productivity school have advanced the proposition that wage-earners tend to get what they produce. This theory has as a natural corollary that the more efficient will get more than the less efficient: the man of greater ability will receive a greater reward than the man with less ability. But few